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December 17, 2004

Ex Parte

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: Core Communications, Inc. Petition for Forbearance under 47 U.S.C. § 160(c) from Application of the ISP Remand Order , WC Docket No. 03-171

Dear Ms. Dortch:

On behalf of Verizon, I am requesting that the attached document supporting SBC's Petition to reinstate the growth caps and new markets rules be filed in the record of the above docket. Please let me know if you have any questions.

Sincerely,

c: Tamara Preiss
Steve Morris

THE COMMISSION SHOULD GRANT SBC'S PETITION FOR REHEARING AND REINSTATE THE GROWTH CAPS AND NEW MARKET RULE

On November 17, 2004, SBC Communications Inc. submitted a petition for reconsideration of the Commission's decision to grant, in part, the petition for forbearance filed by Core Communications, Inc. and to relieve all CLECs from the growth caps and new market rule established in the *ISP Remand Order*. *See* Order, *Core Communications, Inc. Petition for Forbearance Under 47 U.S.C. § 160(c) from Application of the ISP Remand Order*, 19 FCC Rcd 20179 (2004) ("*Core Forbearance Order*"). As SBC demonstrated, the record contained no support for — and, in fact, contradicted — the fundamental premise of the *Core Forbearance Order*, which is that dial-up, ISP-bound minutes of use have declined. Without that premise, the Commission could not have concluded that "policies favoring a unified compensation regime outweigh any remaining concerns about the growth of dial-up Internet traffic" and, therefore, could not have concluded that all the criteria for forbearance were satisfied. *Id.* ¶ 20; *see id.* ¶ 24. The Commission should reconsider its decision to grant forbearance and should reinstate the growth caps and new market rule.

BACKGROUND

1. ISP Remand Order

In the *ISP Remand Order*, the Commission held that "convincing evidence in the record" demonstrated that CLECs "targeted ISPs as customers merely to take advantage of . . . intercarrier payments" for dial-up ISP-bound traffic — approximately two billion dollars annually — and were affirmatively discouraged from providing local voice service. *Id.* ¶ 2; *see id.* ¶¶ 5, 21, 70-71, 87 n.171. Moreover, the Commission recognized that reciprocal compensation payments created market distortions, such that neither ISPs nor their dial-up customers were receiving accurate price signals. *See id.* ¶¶ 68, 71, 74, 77. For both reasons, the

Commission concluded that CLECs, like incumbents, can and should "recover the costs of delivering traffic to ISP customers directly from those customers." *Id.* ¶ 67; *see id.* ¶¶ 87-88.

Although, the Commission recognized that "the record indicates a need for immediate action with respect to ISP-bound traffic," the Commission responded to CLECs' pleas by establishing an interim intercarrier compensation regime. *Id.* ¶ 7; *see id.* ¶ 77. As part of that regime, the Commission established rules — in particular, the rate caps, growth caps, and new market rule — designed to "limit, if not end, the opportunity" for CLECs to engage in "regulatory arbitrage" through serving ISPs. *Id.* ¶ 77; *see id.* ¶¶ 21, 29.

In particular, the Commission explained that the growth caps "ensure that growth in dial-up Internet access does not undermine our efforts to limit intercarrier compensation for this traffic" and that "growth in minutes above the caps is based on a given carrier's ability to provide efficient and quality service to ISPs, rather than on a carrier's desire to reap an intercarrier compensation windfall." *Id.* ¶ 86. The Commission stated that it adopted the new market rule because "[a]llowing carriers . . . to expand into new markets using the very intercarrier compensation mechanisms that have led to the existing problems would exacerbate the market problems we seek to ameliorate." *Id.* ¶ 81. The Commission also noted that "carriers entering new markets to serve ISPs have not acted in reliance on reciprocal compensation revenues and thus have no need of a transition during which to make adjustments to their prior business plans." *Id.*

Based in large part on the Commission's identification of "a number of flaws in the prevailing intercarrier compensation mechanism for ISP calls" — and the Commission's establishment of "rules that sought to limit arbitrage opportunities by lowering the amounts and capping the growth of ISP-related intercarrier payments" — the D.C. Circuit left the

Commission's interim compensation regime in place, even though it did not accept the Commission's reliance on § 251(g) as the basis for excluding ISP-bound traffic from § 251(b)(5). *WorldCom v. FCC*, 288 F.3d 429, 431, 434 (D.C. Cir. 2002).

2. Core Forbearance Order

On July 14, 2003, Core filed a petition seeking forbearance from the rate caps, growth caps, and new market rule, as well as from the "mirroring rule," which was designed to limit the compensation incumbents could receive on non-ISP calls they received. *See ISP Remand Order* ¶ 89; *Core Forbearance Order* ¶ 8. The Commission found that Core's petition plainly failed to meet the standards for forbearance under 47 U.S.C. § 160(a). *See Core Forbearance Order* ¶ 16 ("we find that Core's arguments do not satisfy the requirements of section 10(a)(3)"); *id.* ¶ 18 ("Core presents no evidence to support [its] claims"); *id.* ¶ 25 ("Core makes no specific arguments to demonstrate that forbearance from the rules at issue would satisfy th[e] standard [in § 160(a)(2)]").

Nonetheless, the Commission granted Core's petition in part — forbearing from the growth caps and new market rule not only for Core, but for all CLECs, *see id.* ¶ 27 — based on "other grounds" developed by the Commission *sua sponte*, *id.* ¶ 16. Citing only an analyst report filed in related dockets — but *not* in this docket — and a report issued by the Wireline Competition Bureau, *see id.* ¶ 20 n.56, the Commission found that "[m]arket developments since 2001 have eased the concerns about the growth of dial-up ISP traffic that led the Commission to adopt" the growth caps and new market rule, *id.* ¶ 20. Specifically, the Commission noted that the analyst report "suggests that the number of end users using conventional dial-up access to connect to ISPs is declining as the number of end users using broadband services to access ISPs grows." *Id.* Based only on this, the Commission asserted that it did "not anticipate . . . that the

availability of compensation to carriers that serve ISPs will have any material impact on the migration of consumers from dial-up services to broadband services." *Id.* The Commission then concluded that "the policies favoring a unified compensation regime outweigh any remaining concerns about the growth of dial-up Internet traffic." *Id.*; *see id.* ¶¶ 21, 24.[1]

ARGUMENT

I. THE RECORD EVIDENCE CONTRADICTED THE COMMISSION'S GROUNDS FOR GRANTING FORBEARANCE

As SBC explained in its petition for reconsideration of the Commission's decision to forbear from the growth caps and new market rule, the record provided no support for — and, in fact, contradicted — the Commission's speculation that usage of dial-up ISP service had declined. The analyst report the Commission cited, like the Wireline Competition Bureau report, showed only that the number of broadband lines had increased. As SBC explained, the decision of some end users to switch from dial-up to broadband says nothing about how extensively the remaining dial-up customers are using the Internet. *See* SBC Pet. at 6. Indeed, given the increasing array of information and services available over the Internet since 2001, increased Internet usage should be expected, especially by dial-up end users, who must remain online longer than broadband users to obtain the same content. A recent NTIA report confirms that all online activities — except stock trading — increased from 2001 to 2003.[2]

But there was no need for the Commission to speculate. The evidence in the record demonstrated that, notwithstanding the rate caps, growth caps, and new market rule, dial-up minutes of use have *increased* even as the number of dial-up subscribers have decreased. Qwest, for example, submitted evidence showing that, since 2001, total dial-up ISP traffic had increased

[1] The Commission also found that "neither the growth caps nor the new markets rule is necessary for the protection of consumers." *Id.* ¶ 26.

[2] *See* NTIA, *A Nation Online: Entering the Broadband Age* at 8, Fig. 5 (Sept. 2004).

by *more than 50 percent* in states that had not adopted a bill-and-keep rule for such traffic. *See Qwest Ex Parte*[3] at 3. Individual CLECs had increased their ISP-bound traffic by as much as *ten times* their 2001 levels. *See id.* BellSouth submitted evidence showing that, in its region, CLECs continued to "do very substantial business with ISPs (and have unbalanced traffic far in excess of the caps as a result)." *BellSouth Ex Parte*[4] at 3. BellSouth also submitted an analyst report finding that the number of dial-up ISP minutes of use was *higher* in 2003 than it had been in 2001, and projecting that to remain the case through 2007. *See id.* Attach. 1 ("From 2003-2006, the total minutes of use of dial-up in the U.S. by consumers will *increase* . . . [even as] dial-up subscribers will drop by over 5 million.") (emphasis added); *see also* Ex Parte Letter from Bennett L. Ross, BellSouth, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68 & 96-98 (filed Dec. 17, 2004) (correcting data). In its petition, SBC explains that data from its region are consistent with Qwest's and BellSouth's experience. *See* Pet. at 7.

Verizon's experience is consistent with that of the other BOCs. Even with the rate caps, growth caps, and new market rule, many CLECs in Verizon's region — including Core — still focus exclusively on serving ISPs to reap the payments available under the Commission's interim compensation regime. For example, Verizon still sends CLECs, on average, nearly 14 times as much traffic as it receives. For some CLECs, that ratio is greater than 100:1. In

[3] Letter from Andrew D. Crain, Associate General Counsel, Qwest, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 03-171 (filed Oct. 5, 2004) ("*Qwest Ex Parte*").

[4] Letter from Herschel L. Abbott, Jr., Vice President – Governmental Affairs, BellSouth Corporation, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68 & 96-98 (filed Oct. 1, 2004) ("*BellSouth Ex Parte*").

addition, based on data from the first eight months of 2004, Verizon's customers alone will generate a very conservatively estimated 145 billion minutes of dial-up traffic.[5]

The Commission addressed none of this evidence in its order. Nor did the Commission consider the effect of eliminating the growth caps and new market rule on CLECs' incentives. As shown above, the record evidence demonstrated that dial up, ISP-bound minutes of use had *increased* despite the existence of those rules. There can be no question, therefore, that CLECs will have every incentive to seek to generate even more dial-up, ISP-bound traffic without the constraints of the growth caps and new market rule. Indeed, even aside from the fact that the Commission was wrong in assuming that dial-up minutes of use had decreased, there would still be no basis for presuming that such a trend would continue absent those two features of the interim compensation regime.

II. THE GROWTH CAPS AND NEW MARKET RULE REMAIN JUSTIFIED ON POLICY GROUNDS AND THE COMMISSION FAILED TO CONSIDER ITS PRIOR RATIONALES FOR IMPLEMENTING THOSE RULES

SBC's petition also demonstrates that the Commission, in applying the statutory forbearance criteria, failed to address the actual rationales in the *ISP Remand Order* for establishing the growth caps and new market rule. *See* Pet. at 9-10. Thus, in addressing § 160(a)(3), the Commission speculated that forbearing from the growth caps and new market rule will not have a "material impact on the migration of consumers from dial-up services to broadband services." *Core Forbearance Order* ¶ 20. But the *ISP Remand Order* never mentions broadband, let alone providing incentives for end users to switch to broadband, in the discussion

[5] *See* Letter from Donna M. Epps, Vice President – Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68 & 96-98, Attach. at 18-19 (filed Sept. 27, 2004).

of the interim compensation regime.[6] Instead, the Commission's goal was to ensure that CLECs make economically rational choices between serving ISPs and voice customers. *See*, *e.g.*, *ISP Remand Order* ¶ 29 (finding that intercarrier compensation for ISP-bound traffic "led to classic regulatory arbitrage" with the "troubling effect[]" of "creat[ing] incentives for inefficient entry of LECs intent on serving ISPs exclusively and not offering viable local telephone competition"). The *Core Forbearance Order* ignores this policy goal, and the record evidence demonstrates that the growth caps and new market rule did little to discourage CLECs from serving ISPs at the expense of local voice customers. Eliminating those rules cannot, therefore, be consistent with the public interest.

The Commission also concluded, under § 160(a)(1), that "the growth caps and new market rules are no longer necessary to ensure that charges and practices are just and reasonable." *Core Forbearance Order* ¶ 22. But in reaching that conclusion, the Commission considered none of the specific policy rationales the Commission identified in the *ISP Remand Order* as the bases for those rules.

With respect to the growth caps, the Commission had sought to ensure that "growth in minutes above the caps is based on a given carrier's ability to provide efficient and quality service to ISPs, rather than on a carrier's desire to reap an intercarrier compensation windfall." *ISP Remand Order* ¶ 86. The *Core Forbearance Order* provides no explanation for why a rule that promotes efficient competition has ceased to be a component of "just and reasonable" practices. Indeed, if the Commission were correct that dial-up minutes of use had declined — and it is not — then there would be no harm to leaving the growth caps in place. In fact, it is precisely because the growth caps continue to further the Commission's "efforts to limit

[6] Broadband is mentioned only twice in the order, both times in passing. *See ISP Remand Order* ¶¶ 51, 63 n.122.

intercarrier compensation for [ISP-bound] traffic" that Core sought forbearance. And, for that reason, forbearance is not warranted — it will only further enable CLECs to "compete . . . on the basis of their ability to shift costs to other carriers." *ISP Remand Order* ¶ 71.

With respect to the new market rule, the Commission explained that "carriers entering new markets to serve ISPs have not acted in reliance on reciprocal compensation revenues and thus have no need of a transition during which to make adjustments to their prior business plans." *Id.* ¶ 81. The Commission similarly recognized that the new market rule prevented "the market problems [the Commission sought] to ameliorate" from "expand[ing] into new markets." *Id.* Both considerations are as true today as they were in 2001, and are true regardless of whether ISP-bound traffic is decreasing (as the Commission incorrectly presumed) or increasing (as the record showed). Yet the *Core Forbearance Order* never mentions either consideration.

For all of these reasons, the Commission erred in concluding that "the policy rationale for [the growth caps and new market rule] no longer outweighs policies favoring a unified compensation regime." *Core Forbearance Order* ¶ 24. On the contrary, the policy rationales for — and the public interest in maintaining — the growth caps and new market rule are as strong today as they were in 2001 and continue to outweigh any interest in a unified compensation regime, at least until the Commission acts in its comprehensive, intercarrier compensation proceeding.[7]

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[7] Finally, SBC raises an alternative request for relief in the event the Commission declines to reconsider its grant of forbearance. Specifically, SBC asks that the Commission condition its grant of forbearance by requiring "any carrier that seeks compensation for ISP-bound traffic that would not have been compensable under the growth cap[s] or new market[] rule[] to accept a lower rate for . . . all ISP-bound traffic." Pet. at 10. However, any modification of rate levels would require an amendment of the Commission's ISP intercarrier compensation rules and, therefore, should be addressed as part of the Commission's pending comprehensive intercarrier compensation reform rulemaking. In addition, Verizon notes that, in the *ISP Remand Order*, the Commission recognized that the market distortions created by

intercarrier compensation for ISP-bound traffic "*cannot* be cured by regulators or carriers simply attempting to 'get the rate right.'" *ISP Remand Order* ¶ 76 (emphasis added). It was for this reason that the Commission adopted the growth caps and new market rule *in addition to* the rate caps. The Commission, therefore, should retain the growth caps and new market rule and should not modify the rate caps. In no event, however, would the Commission have grounds for extending any lower rate caps to traffic other than dial-up ISP-bound traffic or for applying the mirroring rule to such a lower rate cap.